



MINUTES

Legislative Property Tax Study Committee

November 14, 2008

MEMBERS PRESENT:

Senator Joe Bolkcom, Co-chairperson
Senator Staci Appel
Senator Roger Stewart

Representative Phil Wise, Co-chairperson
Representative Tyler Olson
Representative Doug Struyk
Representative Roger Wendt

Public Members (Nonvoting):

Ms. Margaret Buckton
Mr. Rick Dickinson
Ms. Christine Hensley
Mr. Tim Johnson
Mr. Edward T. Wallace
Mr. Terry Wegener
Mr. Tom Zucker
Ms. Joanne Mangold
Ms. Lu Barron

Governor's Appointees (Nonvoting):

Mr. Dale Hyman, Department of Revenue
Mr. Charles Krogmeier, Department of
Management
Ms. Amy Johnson, Department of Economic
Development (for Mr. Vince Lintz)

MEETING IN BRIEF

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Minutes prepared by: Michael
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- I. Procedural Business
- II. Consultants' Initial Progress Report on the Property Tax Study
- III. Assessment and Taxation of Telecommunications Companies
- IV. Property Taxes, Alternative Sources of Revenue, and Smart Growth
- V. Local Governments' Ability to Respond to Natural Disasters
- VI. Local Governments' Fiscal Flexibility in Responding to Natural Disasters and Emergencies
- VII. Committee Discussion
- VIII. Materials Filed With the Legislative Services Agency



Legislative Property Tax Study Committee

I. Procedural Business

Call to Order. The fourth meeting of the Legislative Property Tax Study Committee was called to order at 10:06 a.m. on November 14, 2008, in Room 19 of the State Capitol Building.

Approval of Minutes. The minutes of the December 5, 2007, meeting, as previously distributed, were approved by voice vote.

Adjournment. Upon conclusion of the presentations and discussion by the Committee, the meeting was adjourned at 3:32 p.m.

II. Consultants' Initial Progress Report on the Property Tax Study

Dr. Michael Bell and Dr. David Brunori, both research professors of public policy at George Washington University, and Ms. Kristina Connolly, research assistant, reviewed the Initial Progress Report that they prepared on the Property Tax Study contracted for by the Committee. The four chapters of the Initial Progress Report are entitled: (1) Valuation of Commercial and Industrial Properties for Tax Purposes; (2) Indirect Property Tax Relief; (3) Local Revenue Raising and Spending Patterns Across 50 States; and (4) Smart Growth and Property Tax Incentives in State Statutes.

A. Property Valuation

Dr. Brunori stated that the three approaches to property valuation for property tax purposes are the market value approach, the income approach, and the replacement cost approach. The market value approach is a sales comparison approach and is the preferred method for valuing residential property. The use of the market value approach requires similarly situated property and recent comparable sales. Through the use of computer-assisted mass appraisals, the market value approach has become much more accurate for residential property. The income approach is the preferred method for valuing rental and retail property, with its most difficult component being calculation of a capitalization rate.

Dr. Brunori indicated that there is some use of the income approach in valuing commercial and industrial property. The cost approach involves valuing the land and the replacement cost of improvements on the land. The cost approach also allows for depreciation on certain property other than the land. The cost approach method is used most often for commercial and industrial property, but it is also used for all property when it is infeasible to use the other two approaches or when valuing unique property. The cost approach is useful when there are no comparable sales or if determining an income stream for a unique property is difficult. Dr. Brunori noted that, according to the International Association of Assessing Officers, each valuation methodology is used in each state to some degree. Consequently, no state mandates the use of any specific valuation method to the exclusion of the other two. However, certain methods remain preferable for certain types of property.



B. Property Tax Relief

Dr. Michael Bell stated that direct property tax relief reduces property tax liabilities directly, while indirect property tax relief, such as intergovernmental grants and user fees and charges, reduces pressure on the local property tax. According to Dr. Bell, intergovernmental grants reduce pressure on local own-source revenues and compensate for benefit spillovers, which occur with services that provide a benefit to persons outside the local property taxpayers. However, intergovernmental grants are unreliable because of the state's control of how much money the local governments will receive from year-to-year. Additionally, local governments would be placed in the position of competing between themselves and with other state priorities. California was provided as an example of how reliance on property taxes was reduced; however, the new system created competition among the local governments for state dollars. Intergovernmental grants would also reduce the autonomy of local governments to customize programs to their circumstances and would reduce local governments' accountability to the taxpayer. Dr. Bell stated that the reduced autonomy might also reduce efficiency because a single program may not fit across all localities.

In Dr. Bell's review of the 50 states, there appears to be a strong correlation between less property tax being imposed in those states that appropriate a higher amount of state funding to local governments. Nationally, local reliance on state aid declined between 1992 and 2006. In Iowa, local reliance on state aid also declined during that time period, keeping it below the national average. Iowa's local reliance on property taxes is now about 10 percent above the national average. Dr. Bell noted several examples from other states, including New Hampshire, Vermont, and Oregon, to illustrate how an increase in intergovernmental aid can reduce reliance on local property taxes.

Dr. Bell also addressed the implementation of user fees. One of the typical examples of user fees is a local transportation system that collects fares from the user. Although user charges and user fees provide revenue diversification while maintaining local control, these sources have limited growth potential, they give rise to fairness concerns, and they can be prone to administrative difficulty in terms of collection. While user fees show a high correlation between the fee and the benefits received, there is the potential for user fees to disproportionately impact low-income users. Iowa's local reliance on user charges and user fees increased between 1992 and 2006, staying above the national average, which also increased. There is no discernible pattern nationwide between reliance on property taxes and reliance on user charges and fees.

Dr. Bell addressed the initial progress report's examination of revenue capacity. A study was conducted looking at all possible revenue sources in comparison to the national average. Iowa's revenue capacity is 94 percent of the national average. However, Iowa's actual revenue effort is 104 percent of the national average. In response to a question from the Committee, Dr. Bell and Dr. Brunori also addressed the impact of user fees on nonprofit organizations. Most nonprofits are not provided exemptions for user fees. Furthermore, many states are reexamining nonprofit property tax exemptions currently allowed, particularly for nonprofits engaged in business activities.



C. Local Revenue Raising and Spending Patterns Among the States

Dr. Bell stated that examining local spending patterns across states reveals that the bulk of expenditures is on education, public safety, transportation, general administration, and public welfare. There are large variations across states in local revenue raising and spending responsibilities and in the composition of local revenues and expenditures. These variations are a result of historical, cultural, and political differences across states. Dr. Bell referenced several tables within the initial progress report that detail the sources of local government financing and how much reliance is placed on each source. Dr. Bell noted difficulty in drawing significant conclusions in this area because of the wide disparity in spending obligations and financing sources.

D. Smart Growth and Tax Incentives

Ms. Connolly stated that while it has different meanings in different states, the term "smart growth" is generally used to describe a policy intended to result in extensive land use planning, development, and revitalization of urban and rural areas to curb urban sprawl and improve quality of life. Whether or not smart growth is their stated purpose, many states offer preferential tax programs for conservation of land, such as agricultural land, open space, and forestland, and also offer tax incentives for redevelopment and infill development, including mediating Brownfields and constructing affordable housing. Smart growth also in many instances seeks to mix land uses, create walkable communities, and create communities with a distinctive plan. The property tax incentives used include preferential assessments; tax abatements, exemptions, or credits; and tax increment financing. Zoning and other land use regulations are the primary tools used by states and local governments to control development and curb urban sprawl.

The Committee asked Ms. Connolly if there was evidence or research that would identify the states that have succeeded with their smart growth strategies. Ms. Connolly indicated that such information was not part of the report. Additionally, Ms. Connolly stated that finding empirical evidence to show successes would be very difficult, primarily because no states have produced reports on the efficacy of smart growth strategies. Nevertheless, Ms. Connolly indicated that she would attempt to provide some additional information on this issue in the final report.

E. Committee Questions and Discussion

Several members of the Committee posed questions about the initial progress report and indicated certain topics or information that they would like to see included in the final report, including diversification of revenue sources beyond user fees. Committee members discussed with the consultants the approach in valuing commercial property according to its "highest and best use" and asked that the final report include information about whether this practice is used in other states. The Committee also requested that the final report clarify the conclusions that can be drawn from the information and data presented in the report.

Some Committee members questioned the consultants' characterization of California and Michigan as "similarly situated" states. The consultants acknowledged that the demographics and size of those states may be different from Iowa, but stated it is more important to look at local government



structure and centralization. Additionally, the consultants stated that comparisons can be made based on the taxation methods and financing sources that are being implemented.

III. Assessment and Taxation of Telecommunications Companies

Mr. Michael Duster, Legal Counsel, Legislative Services Agency, summarized a research memorandum briefly describing the method by which states located in the Midwest assess the property of telecommunications companies for purposes of property taxation. Mr. Duster highlighted the difficulty many states are having in responding to the rapid service delivery changes in this industry.

IV. Property Taxes, Alternative Sources of Revenue, and Smart Growth

Dr. Peter Fisher and Research Associate Ms. Beth Pearson, both of the Iowa Policy Project, reviewed their policy paper on city revenue and smart growth. They emphasized the need for cities to balance economic development by ensuring that development is sustainable, responsible, and fair. Current development strategies used by cities forego the possibility of regional cooperation and planning and are resulting in economic competition between localities. Ms. Pearson stressed the importance of cities to look beyond property tax. When a city utilizes property taxes as an economic development incentive, it reduces its tax-generating ability, and this often results in a disproportionately negative effect on the budgets of low-income persons. The following sources of revenue could be utilized by cities as an alternative to property taxes: (1) local option sales tax; (2) hotel/motel tax; (3) utility franchise tax; (4) local alcohol, cigarette, and tobacco excise taxes; (5) gambling taxes; and (6) local option income tax. Dr. Fisher averred that the most progressive and sustainable of these is the local option income tax. He noted that revenue sources that mimic the progressive income tax should be utilized.

Dr. Fisher also addressed the overall concept of economic development and how it relates to alternative revenue sources. According to Dr. Fisher, policies that encourage economic development are good; however, if the development would have been established anyway due to market forces, such policies are a waste of resources. An example provided by Dr. Fisher is the practice of using tax increment financing for retail development. Dr. Fisher believes that retail development will establish itself based on where there is a market sufficient to support it without incentives. Instead, Dr. Fisher believes that tax increment financing should be used to develop businesses and industries that produce items to be exported outside the local community.

Members of the Committee questioned Dr. Fisher about local option income taxes and how other states are implementing such a tax. Dr. Fisher indicated that a local option income tax could be used as an indirect economic development tool. The Committee also engaged in a discussion of the difference in providing incentives to create competition between communities within the state and providing incentives in border communities to compete with neighboring states.



V. Local Governments' Ability to Respond to Natural Disasters

A. City of Cedar Rapids

Mayor Pro Tem Brian Fagan and City Manager Jim Prosser showed the Committee a video of the flood damage in Cedar Rapids and described the magnitude of the summer flooding and its effect on citizens, property, and city government. Mr. Prosser stated that last year Cedar Rapids created a long-term financial plan. At that time the city was looking at a gap of \$14 million in the next year alone. Following the floods, those estimates have been revised to show a \$23 million shortfall. This financial situation may force the city to increase property taxes by as much as 20 percent. Mr. Prosser expressed concern for a potential increase because Cedar Rapids' tax rates are already higher than comparable communities.

Mr. Prosser noted the need for construction and reconstruction of housing and business and government buildings. Seventy-two percent of the city's general fund is supported by property taxes. The loss in property tax value due to the flood is estimated to be \$81.7 million. He stated that the city cannot afford to support its recovery and rebuilding efforts within the existing state policies regarding funding for economic development. Current city debt limits are likely to curtail the ability of Cedar Rapids to reinvest in infrastructure, and the current state formula for funding transportation does not reflect the cost to maintain roads in regional centers like Cedar Rapids. Also, Cedar Rapids must be able to continue to offer property tax incentives, like tax increment financing, in order to compete nationally and internationally for commercial and industrial development. The loss in property valuations due to the flooding makes it difficult to utilize this economic development tool. Mr. Prosser has talked to specific employers in Cedar Rapids who indicated that the current situation has impacted their ability to attract and retain employees.

Mr. Fagan stated the state's reluctance to access state reserve funds, known as "rainy day funds," for flood recovery is further impetus to explore alternative sources of revenue. Mr. Fagan provided a list of legislative proposals to assist local governments in reducing reliance on property taxes and suggested that the legislation initially only apply to cities with a population in excess of 50,000 and with at least 25 percent of their tax base comprised of commercial and industrial property. The list of legislative proposals included diversified revenue sources such as franchise fees, local income taxes, hotel and motel taxes, as well as economic incentives like flood impact enterprise zones, scattered-site tax increment financing districts, and expanded bonding capacity. Mr. Fagan noted the importance of increasing efficiency of local governments and noted that Cedar Rapids has eliminated 50 supervisory positions and is exploring the possibility of combining city, county, and school office sites.

B. Linn County

Ms. Dawn Jindrich, Linn County Budget Director, stated that Linn County does not have the general fund money available for repair or replacement of county buildings damaged during the flooding, and Federal Emergency Management Agency money will not be adequate. The county will experience a county jail revenue loss of \$3 million because of the inability to house prisoners there. There will also be a decrease in property tax collections due to flood-damaged buildings. Linn County is facing the possibility of finding housing for up to 1,200 people. Currently, funding



for housing is coming in the form of community development block grants; however, this money is unlikely to be sufficient for the reconstruction of lost housing, most of which was workforce housing.

Ms. Jindrich recommended that the current project cost limits on nonreferendum bond issuances be raised, that the reverse referendum requirement for authorization to use local option sales tax to retire debt be suspended, and that the maximum local hotel/motel tax rate be raised. Committee member Lu Barron, who is a Linn County Supervisor, distributed information on the effects of the flooding and provided a list of flood-related services provided by Linn County. Ms. Jindrich indicated that the county recently approved a \$1 billion flood mitigation plan, of which \$350 million will be funded by the cities.

Committee members questioned whether Linn County had looked at other communities or states facing disaster recovery, such as New Orleans, Florida, and Texas. Ms. Jindrich indicated that they had reviewed reports that identified weaknesses and successes in those communities.

VI. Local Governments' Fiscal Flexibility in Responding to Natural Disasters and Emergencies

A. City Perspective

Mr. Alan Kemp, Executive Director, Iowa League of Cities, provided a variety of statistical information on Iowa city budgets. On average, general fund expenditures for all cities are comprised of expenditures on public safety (44 percent), culture and recreation (20 percent), general government administration (14 percent), public works (12 percent), health and social services (4 percent), community and economic development (4 percent), and capital projects (2 percent). Mr. Kemp identified Des Moines (58 percent) as an example of how larger cities spend a higher percentage of their general fund expenditures on public safety.

Mr. Kemp agreed with the consultants' conclusion that there is an overreliance on property taxes in Iowa. On average, property taxes account for 52 percent of a city's general fund revenues. He stated that 784 of Iowa's 947 cities are at their \$8.10 general fund property tax levy limit, and 334 cities are utilizing their emergency levy. Mr. Kemp outlined several proposals for statutory and regulatory changes related to debt issuance, contracting for emergency repairs, and city budgetary requirements in times of emergency. Specifically, he pointed to the types of activities that are considered an "essential corporate purpose," the possibility of extending the duration of bonds, and changes in public bidding laws as potential areas for policy changes.

Mr. Kemp stated that cities should have alternative revenue options in order to decrease the reliance on property taxes and to allow individual cities to determine the most appropriate revenue alternative for their community. According to Mr. Kemp, alternative revenue sources are needed due to the inelastic nature of property tax revenue. He indicated support for the enactment of a menu of options that would allow cities to provide flexibility and autonomy for local governments. He also stated that, in light of the recent economic downturn, this proposed menu of options has increased importance beyond disaster recovery.



Legislative Property Tax Study Committee

Committee members agreed that options with flexibility are needed, but noted past difficulties in generating wide support. Mr. Kemp acknowledged that compromise would need to occur to get a menu of revenue options enacted. Committee members stated that there will be an expectation that enactment of a menu of revenue options will produce a reduction in property taxes and require local governments to look at efficiency.

B. County Perspective

Mr. Jay Syverson, Fiscal Analyst, Iowa State Association of Counties, reviewed the current statutory authorizations that counties may utilize in responding to natural disasters or other emergencies. A county may abate or suspend payment of property taxes any time if the board of supervisors determines that the person is "unable to contribute to the public revenue" and may abate property taxes on property destroyed by natural disaster or other unavoidable casualty to the extent that insurance does not cover the loss. He recommended several statutory changes, relating primarily to debt issuance, that would allow counties more flexibility to respond to, and recover from, natural disasters and emergencies. He also proposed other statutory changes affecting county budgets, including authorization of a local option income tax, repeal of sales tax increment financing, and increased state funding for mental health services.

Committee members questioned Mr. Syverson about the potential for property tax bills to increase if certain proposals like expanded bonding capacity are enacted, despite an increased repayment period.

VII. Committee Discussion

The Committee instructed Legislative Services Agency staff to communicate with the property tax study consultants on the direction of their research in anticipation of the Final Report to be issued on December 30. Staff was also instructed to communicate with interest groups on prioritizing the recommendations they have made to the Committee.

VIII. Materials Filed With the Legislative Services Agency

The following materials listed were distributed at or in connection with the meeting and are filed with the Legislative Services Agency. The materials may be accessed from the <Additional Information> link on the Committee's Internet website:

<http://www.legis.state.ia.us/aspx/Committees/Committee.aspx?id=209>

1. Iowa Property Tax Study November Presentation — George Washington Institute of Public Policy
2. Property Tax Assessment of Telecommunications Companies — Legislative Services Agency
3. Executive Summary — City Revenue and Smart Growth — The Iowa Policy Project



4. City Revenue and Smart Growth — The Iowa Policy Project
5. Local Governments' Ability to Respond to Natural Disasters/Emergencies — City of Cedar Rapids
6. Local Governments' Ability to Respond to Natural Disasters/Emergencies — Linn County
7. Linn County Flood Fact Sheet — County Supervisor Lu Barron
8. City Fiscal Flexibility in Responding to Natural Disasters/Emergencies — Iowa League of Cities
9. County Fiscal Flexibility in Responding to Natural Disasters/Emergencies — Iowa State Association of Counties

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